BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NEBRASKA

In the Matter of the Application of SourceGas Distribution LLC, Golden Colorado, seeking authority to reflect changed depreciation rates on its Nebraska Books of Account effective May 1, 2014, without impacting existing rates.	)))))))	**Docket No. NG-0079**

DIRECT TESTIMONY AND EXHIBITS

OF WILLIAM DUNKEL

ON BEHALF OF

THE NEBRASKA PUBLIC ADVOCATE

August 21, 2014

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I. Introduction

Q. Please state your name and business address.

A. My name is William Dunkel. My business address is 8625 Farmington Cemetery Road, Pleasant Plains, Illinois 62677.

Q. What is your present occupation?

A. I am a consultant providing services in utility regulatory proceedings. I am the principal of William Dunkel and Associates, which was established in 1980. Since that time, I have regularly provided expert consulting services in utility regulatory proceedings throughout the country. I have participated in over 250 state regulatory proceedings before over one-half of the state commissions in the United States. I have participated in utility regulatory proceedings for over 30 years.

I provide, or in the past have provided, services in utility regulatory proceedings to the following clients:

The Public Utility Regulatory Commission or the Staffs in the States of:

Arkansas	Maryland
Arizona	Mississippi
Delaware	Missouri
D.C.	New Mexico
Georgia	Virginia
Guam	Washington
Illinois	U.S. Virgin Islands
Kansas	

The Office of the Public Advocate, or its equivalent, in the States of:

Alaska	Maryland
California	Michigan
Colorado	Missouri
District of Columbia	New Jersey

Georgia	New Mexico
Hawaii	Ohio
Illinois	Pennsylvania
Indiana	Utah
Iowa	Washington
Maine	

The Department of Administration in the States of:

Illinois	South Dakota
Minnesota	Wisconsin

Q. Are you a member of any depreciation professional organization?

A. Yes. I am a senior member in good standing of the Society of Depreciation Professionals. I made a presentation pertaining to Current Depreciation Issues in State Rate Case Proceedings at the Society of Depreciation Professionals 25th Annual Meeting held September 2011 in Atlanta, GA.

Q. Did you prepare an Appendix that describes your qualifications?

A. Yes. My qualifications are shown on Appendix A.

Q. What type of client does your firm most frequently serve?

A. Nationwide my firm participates on behalf of the Commission Staffs or State Utility Regulatory Commissions in the majority of our cases. In the past five years 65% of my firm's cases have been on behalf of the Commission Staffs or State Utility Regulatory Commissions. In the past five years 52% of my personal cases have been on behalf of the Commission Staffs or State Utility Regulatory Commissions. As a frequent Staff witness, I understand that proper depreciation rates are fair to all parties, including investors, current ratepayers and future ratepayers.[1] I have incorporated this proper concept into my recommendations in this proceeding.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Nebraska Public Advocate ("Public Advocate" or "PA")

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to determine the appropriate utility regulatory depreciation rates pertaining to SourceGas Distribution LLC ("SourceGas" or "Company"). I also address the appropriate effective date for these depreciation rates.

I recommend the depreciation rates shown in column G on page 1 of Exhibit WDA-1 be effective at the same time the charges to ratepayers resulting from the next SourceGas general rate case go into effect.[2]

II. Summary

Q. Please compare the Public Advocate proposed depreciation rates to the SourceGas proposed depreciation rates.

A. Below is a table which summarize the Public Advocate recommended depreciation rates and annual accrual amounts compared to SourceGas proposed. The accrual amounts are based on 12/31/2013 investments.

[1] I also followed the depreciation requirements as contained in the FERC Uniform Systems of Accounts (USOA). In addition, the "Public Utility Depreciation Practices" published by NARUC in 1996 contains detailed practices for calculating utility regulatory depreciation rates under USOA, which I follow.

[2] Unless the Commission has further revised the depreciation rates by that time. A minor difference in timing, such as making the revised depreciation rates effective on the 1st of a month for ease of calculations, would not be significant or objectionable.

Table 1: COMPARISON ACCRUAL RATES

Account	Description	12/31/13 Investment	Current Approved Accrual Rate	Company Proposed Accrual Rate	Company Proposed Difference from Current	Public Advocate Proposed Accrual Rate	Public Advocate Proposed Difference from Current	Public Advocate Proposed Difference from Company
		A	B	C	D=C-B	E	F=E-B	G=E-C
376	Mains	102,948,207	3.00%	1.19%	-1.81%	0.98%	-2.02%	-0.21%
380	Services	21,784,000	3.00%	3.97%	0.97%	2.72%	-0.28%	-1.25%
381	House Meters	16,763,867	3.00%	3.44%	0.44%	3.44%	0.44%	0.00%
381.1	AMR Equipment	7,252,026	5.00%	3.72%	-1.28%	3.72%	-1.28%	0.00%
382	Meter Installation	4,857,483	3.00%	1.85%	-1.15%	1.49%	-1.51%	-0.36%
383	House Regulators	6,468,652	3.00%	2.02%	-0.98%	2.02%	-0.98%	0.00%
Grand Total		160,074,236	3.09%	1.97%	-1.12%	1.65%	-1.44%	-0.32%

Table 2: COMPARISON ANNUAL ACCRUAL AMOUNTS

Account	Description	12/31/13 Investment	Current Approved Accrual Amount	Company Proposed Accrual Amount	Company Proposed Difference from Current	Public Advocate Proposed Accrual Amount	Public Advocate Proposed Difference from Current	Public Advocate Proposed Difference from Company
		A	B	C	D=C-B	E	F=E-B	G=E-C
376	Mains	102,948,207	3,088,446	1,222,973	(1,865,473)	1,004,920	(2,083,527)	(218,054)
380	Services	21,784,000	653,520	865,332	211,812	592,340	(61,180)	(272,992)
381	House Meters	16,763,867	502,916	577,393	74,477	577,393	74,477	0
381.1	AMR Equipment	7,252,026	362,601	269,975	(92,627)	269,975	(92,627)	0
382	Meter Installation	4,857,483	145,725	90,071	(55,653)	72,474	(73,250)	(17,597)
383	House Regulators	6,468,652	194,060	130,794	(63,265)	130,794	(63,265)	0
Grand Total		160,074,236	4,947,268	3,156,538	(1,790,729)	2,647,896	(2,299,372)	(508,643)

III. SourceGas Proposes to Record on Its Books Less Depreciation Expense Than It Actually Charges to Ratepayers.

Q. What is a major problem with the SourceGas proposal?

A. SourceGas is proposing to record on its books less depreciation expense than it actually recovers from the ratepayers. For example for the largest account, Mains, SourceGas would collect from ratepayers the depreciation expense based on a 3.00% depreciation rate, but would record on its books that it had only collected the depreciation expense that result from a 1.19% depreciation rate. SourceGas is proposing to record on its books an amount for depreciation expense that it less than is actually collecting from the ratepayers. The result would be understated and inaccurate booked amounts that would result in future overcharges to the ratepayers.

An analogy is that each month you actually make a mortgage payment that, in addition to paying for interest and for other things, includes $1,000 for the principle, and the mortgage company has been properly recording that $1,000 per month towards the principle.[3] However, the mortgage company starts recording on its books that you are only paying $400 per month for the principle, in spite of the fact you are actually still paying $1,000 per month for the principle. In the future the mortgage company's records will understate the total that you have actually paid, and therefore will overstate the amount you still owe. This would clearly be improper, but it is a reasonable analogy to what SourceGas proposes.

Q. Like the above "mortgage" illustration, does SourceGas propose to lower the amount it will record on its books, without changing the amount it collects from ratepayers?

A. Yes. Even the caption of this Docket No. NG-0079 states SourceGas proposes to change the depreciation rates that it will record on its books, without changing the charges to ratepayers.

The caption includes SourceGas: "…seeking authority to reflect changed depreciation rates on its Nebraska Books of Account effective May 1, 2014, without impacting existing rates." (Emphasis added).

[3] The $1,000 per month is towards the principle. The total mortgage payment you pay is higher than $1,000 because you also pay for other things such as interest, and perhaps insurance and real estate taxes.

The Company Application in Docket No. NG-0079 also states that SourceGas proposes to change the depreciation rates that it will record on its books, without changing the rates charged to ratepayers. The first paragraph in the SourceGas May 1, 2014 Application states:

> "…SourceGas Distribution hereby files this Application requesting that the Commission, through the power, authority and jurisdiction granted to it by Section 66-1804 of the State Natural Gas Regulation Act (the "Act"), issue an order authorizing the Company, as of May 1, 2014, to reflect changed depreciation rates on its Nebraska books of account as recommended in the Depreciation Rate Study (Appendix 1). As further explained in this Application, the change in depreciation rates will not impact the Company's current rates in Nebraska for natural gas service for its jurisdictional Residential and Commercial customers." (Emphasis added).[4]

It is very clear from the above quotations that SourceGas proposes that it be allowed to record on its books depreciation expenses based on a different set of depreciation rates than the set of depreciation rates it recovers in charges to ratepayers.

Q. What depreciation expense would SourceGas continue to charge the ratepayers?

A. SourceGas would continue to charge the ratepayers the current base rates (prices). These current charges include recovery of the depreciation expenses at the current depreciation rates. For example for the largest account, Mains, the current prices include recovery of the depreciation expense that results from a 3.00% depreciation rate.[5] SourceGas proposes those current base prices continue to be charged to ratepayers. In its charges to ratepayers, SourceGas would continue to charge ratepayers depreciation expense at a 3.00% depreciation rate for Mains.

[4] First paragraph, cover letter dated May 1, 2014 in Docket No. NG-0079. Signed by Stephen M. Bruckner, Counsel for SourceGas Distribution LLC.
[5] Account 376, Distribution Mains is the largest account.

Q. What depreciation expense does SourceGas proposes to record on its books?

A. SourceGas proposes that it be allowed to record on its books depreciation expenses based on a set of depreciation rates that are different than the set of depreciation rates that are being recovered in the charges to ratepayers. For example for Mains, SourceGas proposes that it be allowed to record on its books depreciation expense at only a 1.19% depreciation rate.

Under its proposal, SourceGas would continue to charge ratepayers the depreciation expense for Mains based on a 3.00% depreciation rate, but would record on its books the lower depreciation expense calculated at a 1.19% depreciation rate for Mains.[6]

SourceGas would record on its books much less depreciation expense than was actually being collected from ratepayers.

Q. Is the set of depreciation rates that SourceGas proposes to record on its books lower overall than the set of depreciation rates it recovers in charges to ratepayers?

A. Yes. The set of depreciation rates that SourceGas proposes that it be allowed to record on its books is significantly lower overall than the set of depreciation rates it will continue to recover in charges to ratepayers.

For the accounts included in the SourceGas Depreciation Study, the weighted average of the current depreciation rates is 3.09%.[7] The current prices charged ratepayers includes recovery of depreciation expense based on these current depreciation rates. SourceGas

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[6] To understand the concept, using a hypothetical $50,000,000 plant-in-service amount, at a 3% depreciation rate the annual depreciation expense would be $1,500,000 ($50,000,000 * 3.00% = $1,500,000). At a 1.19% depreciation rate the annual depreciation expense would be $595,000 ($50,000,000 * 1.19% = $595,000).

[7] Calculated from Appendix B, SourceGas Depreciation Rate Study, Exhibit DAW-4. $4,947,267.60 “Depreciation Expense at Current Rates”/ $160,074,235.86 “Plant at 12/31/2013” = 3.091%.

will continue to charge ratepayers prices that include recovery of these current depreciations rates.

The weighted average of the depreciation rates that SourceGas proposes be used for booking purposes is 1.97% for these accounts. [8]

The depreciation rates that SourceGas proposes that it be allowed to record on its books (1.97% average) are significantly lower overall than the depreciation rates it will continue to recover in charges to ratepayers (3.09% average).

The SourceGas proposal would create a discrepancy between the depreciation expense that is actually being collected from ratepayers and the depreciation expense recorded on the books. Of course this discrepancy creates errors. In future rate cases and in future depreciation studies this discrepancy will improperly benefit SourceGas and improperly harm the ratepayers, as will be discussed later in this testimony.

Q. In this proceeding SourceGas proposes to use depreciation rates for booking purposes that are different than the depreciation rates that are recovered in charges to ratepayers. Does this discrepancy currently exist?

A. No. Currently SourceGas records on its books depreciation expenses calculated using the same set of depreciation rates it recovers in charges to ratepayers.

To change to using a set of depreciation rates for booking purposes that is different than the set of depreciation rates that SourceGas recovers in charges to ratepayers would be a change from the current practice.

[8] Calculated from Appendix B, SourceGas Depreciation Rate Study, Exhibit DAW-4. $3,156,538.38 “Depreciation Expense at Proposed Rates”/ $160,074,235.86 “Plant at 12/31/2013” = 1.972%.

IV. Depreciation Rates Effective Date

Q. What do you recommend on this issue?

A. I recommend that SourceGas' proposal to create a discrepancy between the depreciation charged to ratepayers and the depreciation recorded in the books be rejected.

Under the SourceGas proposal the depreciation recorded on the books would not reflect the depreciation actually charged to ratepayers. Instead of creating a discrepancy, the obvious solution to the problems created by this SourceGas proposal, is to continue to use the same set of depreciation rates for booking purposes as the set of depreciation rates used for the purpose of determining rates (prices) charged ratepayers, until the next general rate case. In the next general rate case a new set of depreciation rates can be incorporated into both the prices charged ratepayers and the depreciation rates for booking purposes. This would avoid the discrepancy.

Q. Does the company proposed May 1, 2014 effective date play a large part in this discrepancy?

A. Yes. The fact that the Company recommends the new depreciation rates be effective for booking purposes on May 1, 2014 creates the problem of booking depreciation rates that are different than the depreciation rates recovered in charges to ratepayers. The base rates charged ratepayers are subject to change in the next SourceGas general rate case. Therefore under the Company proposal, between May 1, 2014 and the conclusion of the next general rate case, different depreciation rates would be used for booking purposes than the depreciation rates incorporated into the prices charged to ratepayers.

Since SourceGas will continue to recover the current depreciation rates in base rates charged to ratepayers until the conclusion of the next SourceGas general rate case, the depreciation expense recorded on the SourceGas books should also be based on the same ("current") depreciation rates, until the conclusion of the next SourceGas general rate case.

I recommend that the new depreciation rates that result from the Commission order in this proceeding first be booked at the same time that next SourceGas general rate case charges to ratepayers go into effect.[9] This eliminates the Company proposed inconsistency between the set of depreciation rates used for booking purposes and the set of depreciation rates recovered in charges to ratepayers.

V. The Depreciation Reserve

Q. You previously stated that the company's proposed discrepancy between the depreciation expense recorded on its books and the depreciation that is actually being collected from ratepayers would result in improper future charges in future rate cases and in future depreciation studies. Please explain why this would occur.

A. On the USOA books an amount equal to the depreciation expense is credited into Account 108, the Accumulated Provision for Depreciation (accumulated depreciation reserve).[10] Therefore to record on its books a depreciation expense that is less than the depreciation expense that SourceGas is actually charging ratepayers, would also result in

[9] Unless the Commission has further revised the depreciation rates by that time. A minor difference in timing, such as making the revised depreciation rates effective on the 1st of a month for ease of calculations, would not be significant or objectionable.

[10] The Uniform System of Accounts (18CFR201) states:

> **108 Accumulated provision for depreciation of gas utility plant.**
> A. This account shall be credited with the following: (1) Amounts charged to account 403, Depreciation Expense, …

recording on the books an accumulated depreciation reserve amount that is less than the accumulated depreciation that has actually been recovered from ratepayers.

In future proceedings, the book amount of the accumulated depreciation reserve will be used to:

(1) calculate depreciation rates in future depreciation studies; and
(2) calculate net rate base in future rate cases.

As will be discussed, if SourceGas is allowed to record on its books an accumulated depreciation reserve amount that is less than the accumulated depreciation that has actually been recovered from ratepayers, that would result in both excessive and improper future depreciation rates and excessive and improper future net rate bases.

Q. Can you illustrate how recording on the books a depreciation expense that is less than the depreciation expense charged to ratepayers will also result in the book accumulated depreciation reserve also being understated?

A. Yes. Assume a hypothetical company has $50,000,000 plant in service in the Distribution Mains account. If the prices charged ratepayers recover a 3.00% depreciation rate, then the hypothetical company would recover from the ratepayers $1,500,000 annual depreciation expense for this account.[11]

However, if this hypothetical company were allowed to use a 1.19% depreciation rate for booking purpose for this account, the annual depreciation expense it would book would be only $595,000.[12] Because the book depreciation expense is credited into the

[11] Using a hypothetical $50,000,000 plant-in-service amount, at a 3% depreciation rate the annual depreciation expense would be $1,500,000 ($50,000,000 * 3.00% = $1,500,000).
[12] At a 1.19% depreciation rate the annual depreciation expense would be $595,000 ($50,000,000 * 1.19% = $595,000).

accumulated depreciation reserve, $595,000 would be credited into the accumulated depreciation reserve per year.[13] Since the hypothetical company would have actually charged ratepayers $1,500,000 in annual depreciation expense, the $595,000 amount credited into the accumulated depreciation reserve that year would be $905,000 less than the depreciation expense actually charged to ratepayers. If this continued for several years until the next rate case, the amount in Account 108, Accumulated Depreciation on the books could be several million dollars less than the total accumulated depreciation amount actually recovered from the rates charged ratepayers.

Q. Has the U.S. Supreme Court stated that "…the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment which has been made out of the proceeds of telephone rates ..."?

A. Yes. The U.S. Supreme Court has stated that "…the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment which has been made out of the proceeds of telephone rates ..."

The U.S. Supreme Court decision in Lindheimer v. Illinois Tel. Co. states:

> "While property remains in the plant, the estimated depreciation rate is applied to the book cost and the resulting amounts are charged currently as expenses of operation. The same amounts are credited to the account for depreciation reserve, the "Reserve for Accrued Depreciation".....As the allowances for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment which has been made out of the proceeds of telephone rates for the

[13] The Uniform System of Accounts (18CFR201) states:

108 Accumulated provision for depreciation of gas utility plant.

A. This account shall be credited with the following: (1) Amounts charged to account 403, Depreciation Expense, …

> ostensible purpose of replacing capital consumed."[14] (Emphasis added. Footnotes omitted)

VI. SourceGas Would Double-Recover Some of the Investments.

Q. What is one improper charge that would result from SourceGas' proposal to record on its books less book accumulated depreciation reserve than the accumulated depreciation actually recovered in the rates charged to ratepayers?

A. As previously discussed, the SourceGas proposal would record less in the book accumulated depreciation reserve than the accumulated depreciation amount that has actually been recovered in the rates charged to past ratepayers. This would occur because the depreciation rates that would be booked are overall lower than the depreciation rates being recovered in ratepayer charges. Of course this discrepancy creates errors. These errors improperly benefit SourceGas, and improperly harm the ratepayers.

One problem caused by the SourceGas-proposed discrepancy between the depreciation rates booked and the depreciation rates charged ratepayer is SourceGas would double recover some of the investments. Recovering the same investment twice is improper.

In proper depreciation policy, the utility should recover the full amount of the investment (adjusted for net salvage) that is consumed in the provision of service. But the utility should not over-recover that investment. Under the SourceGas proposal the Company would double-recover part of the investment.

[14] Page 169 of Lindheimer v. Illinois Tel. Co., 292 U.S. 151 (1934).

Q. How does SourceGas' proposal to record on the books less book accumulated depreciation reserve than the accumulated depreciation actually recovered in the rates charged to ratepayers result in double recovery?

A. In a depreciation study the book accumulated depreciation reserve amount is deducted in the calculation of the depreciation rate, with the intention of deducting the accumulated amount that has already been recovered from the ratepayers in past depreciation expense. However, in future depreciation studies the amount in the book accumulated depreciation reserve would be less than the accumulated depreciation actually recovered in the rates charged to past ratepayers, under the SourceGas proposal. The amount that past ratepayers had actually paid, but SourceGas had not credited into the book accumulated depreciation reserve, would not be deducted in the future depreciation rate calculation. Therefore, in the future depreciation rate calculation that amount would not appear to have been collected, and would be collected again in future depreciation rates.

As an analogy, assume that the original principle amount of your mortgage was $200,000. Each month for 60 months you have actually made a mortgage payment that includes $1,000 for the principle.[15] As a result you have paid off $60,000 of the principle, and you still owe $140,000.[16]

However, the mortgage company improperly recorded on its books that you were only paying $400 per month for the principle; in spite of the fact you were actually paying $1,000 per month for the principle. The mortgage company books show you paid $400

[15] $1000 per month times 60 months = $60,000. In total you were paying more than $1,000 per month since you were also paying interest and perhaps insurance and real estate taxes.
[16] $200,000 - $60,000 = $140,000

per month for 60 months for the principle, so you have paid off $24,000[17] and still owe $176,000 on the principle, according to the mortgage company books.[18] Based on its books, the mortgage company would collect $176,000 more from you in the future for the principle. The $176,000 you would have to pay in the future, plus the $60,000 you have actually paid in the past, totals $236,000 for principle. This is a $36,000 overcharge for a $200,000 principle. Because the mortgage company records did not accurately record the amount you had actually paid in the past for the principle, the mortgage company would double recover $36,000 of the principle.

The depreciation rate calculation is similar, as is shown by Appendix A of the SourceGas Depreciation Study.[19] A copy of this page is attached at Exhibit WDA-2 for easy reference. The depreciation rate calculation starts with the total amount that needs to be recovered over time. On the first line of Appendix A the total amount that needs to be recovered over time is $113,243,027.73.[20] This is the Surviving Balance of $102,948,207.03 plus the Net Salvage Amount of $10,294,820.70.[21]

The book Accumulated Depreciation amount of $55,503,667.76 is deducted, with the intention of deducting the accumulated amount that has already been recovered from the ratepayers in past depreciation expense. This leaves the “Unaccrued Balance” of $57,739,359.97. The depreciation rates are specifically calculated to recover this “Unaccrued Balance” amount in future depreciation rates.

[17] $400 * 60 months = $24,000.
[18] $200,000 - $24,000 = $176,000.
[19] Exhibit DAW-4.
[20] This is for Account 376, Mains (Distribution Mains).
[21] Net salvage is deducted. However, since this is a negative net salvage amount, deducting a negative net salvage adds to the total that needs to be recovered.

The problem is that in a future similar depreciation rate calculation the book Accumulated Depreciation amount would be less than accumulated depreciation amount that had actually been recovered from the ratepayers in past depreciation expense. This would occur because the depreciation rate used on the books would be lower than the depreciation rate collected in prices charged ratepayers, under the SourceGas proposal.

The amount that had already actually been collected from ratepayers in past depreciation, but had not been included in the book accumulated depreciation amount, would not be deducted in the future depreciation rate calculation. As a result, this amount would be included in the “Unaccrued Balance” amount. Because it is included in the “Unaccrued Balance” amount, it would be recovered in future depreciation rates, in spite of the fact that it had already actually been recovered in past depreciation. By failing to record in the book accumulated depreciation reserve the accumulated amount that has actually been recovered in the rates charged to past ratepayers, SourceGas would double recover some of the investments.

Not only would future depreciation rates be higher than they otherwise would have been, but SourceGas would be double recovering some of the investments, which is an improper depreciation concept.

VII. The "Net" Rate Base Would be Overstated in Future General Rates Cases; Therefore, Ratepayers Would be Charged a Rate-of-Return on Ratepayer-Provided Funds

Q. You previously discussed the use of the book accumulated depreciation reserve in depreciation rate studies. Is the book accumulated depreciation reserve amount also used in calculating the "net" rate base in a general rate case?

A. Yes. In a general rate case the accumulated depreciation reserve as recorded on the books is deducted when calculating the "net" rate base.[22] In a general rate case the rate-of-return is applied to the "net" rate base. The reason the accumulated depreciation reserve is deducted when calculating the "net" rate base is to deduct the ratepayer-provided funds that had been accumulated through past depreciation expense. It is reasonable to provide investors with a rate-of-return on investor-provided funds, but not on ratepayer-provided funds.

Q. If the SourceGas proposal is adopted, in future rate cases would deducting the book amount of Account 108, Accumulated Depreciation Reserve, actually remove all of the ratepayer-provided funds that had been accumulated through past depreciation expense?

A. No. As previously discussed, the SourceGas proposal would record less in the book accumulated depreciation reserve than the accumulated depreciation amount that has actually been recovered in the rates charged to past ratepayers. This would occur because the depreciation rates that would be booked would be overall lower than the depreciation rates being recovered in charges to ratepayers.

[22] An example of the deduction of the "Accumulated Depreciation" when calculating the net rate base (also called "Total Rate Base") can be seen on Company Exhibit "Docket No. NG-0079, Exhibit JSH-1, Docket No. NG-0079 Appendix 2 …. Table 2, Schedule B, Page 1" on line 4.

The fact that the <u>book</u> accumulated depreciation reserve amount is <u>less</u> than the accumulated depreciation amount that has <u>actually</u> been recovered in the rates charged to past ratepayers means that deducting the <u>book</u> accumulated depreciation reserve amount would leave some ratepayer-provided funds in the “net” rate base. When the rate-of-return is applied to that “net” rate base, the investors would receive a return on these ratepayer-provided funds.

Charging ratepayers a rate-of-return on ratepayer-provided funds is improper, but it is exactly what would occur in future rate cases if the SourceGas proposal is adopted.

SourceGas proposes that the depreciation rates that would be booked be overall lower than the depreciation rates being recovered in charges to ratepayers. Of course this discrepancy creates errors. These errors improperly benefit SourceGas, and improperly harm the ratepayers. One way this proposed discrepancy would improperly benefit SourceGas, and improperly harm the ratepayers, is that in future rate cases ratepayers would pay the investors a rate-of-return on ratepayer-provided funds. This would be improper.

Q. If a discrepancy between the depreciation rates that would be booked and the depreciation rates being recovered in charges to ratepayers started now, but ended in the next SourceGas general rate case, would that discrepancy have an impact long after that next general rate case?

A. Yes. Any error created in the next few years in the book accumulate depreciation reserve would last for decades.

Account 108, Accumulated Depreciation, is a continuing record. As a result, any discrepancy in the depreciation reserve amounts recorded during the next few years would be carried forward decades into the future.

The calculation of the amount in the accumulated depreciation reserve at the end of the current year starts with the amount that was in the accumulated depreciation reserve at the end of the prior year. The entries during that current year are added to, or deducted from, the balance at the end of the prior year, to calculate the balance at the end of the current year. The process is shown on Exhibit WDA-3.[23]

In this process, any error in the book amount at the end of the prior year will be carried forward into the balance at the end of the current year.

This same process occurs year after year. As a result, any errors in the accumulated depreciation reserve that would be created during the next few years under the Company proposal would be carried forward for decades, even if the creation of additional errors ceased in the next general rate case.[24]

Since any error in the Account 108, Accumulated Depreciation Reserve, amount would be carried forward for decades into the future, ratepayers would be charged a rate-of-return on ratepayer-provided funds for decades into the future, if the SourceGas proposal is adopted.

[23] The process of starting with the "Balance at the Beginning of Year" (line 1) to calculated the end of year Account 108, Accumulated Provision for Depreciation (accumulated depreciation) reserve amount at the end of the year shown on Exhibit WDA-3 which is page 219 from the SourceGas Distribution LLC's FERC Form 2 for the year 2013. This document was provided by the Company in response to Information Request No. PA-9 (Note that amounts shown may include jurisdictions in addition to Nebraska, but the process is the same in Nebraska).

[24] To be clear the depreciation expense the Company would record on its books is the same amount it would credit into the depreciation reserve. However, this amount is inconsistent with the depreciation expense that the Company would be collecting in rates charged to ratepayers.

Charging ratepayers a rate-of-return on ratepayer-provided funds is improper, but this would occur for decades in the future under the Company proposal.

VIII. "Partial" Offset

Q. Regarding the Company proposed change in depreciation rates, without changing the rates charged customers, Jerrad S. Hammer states:

> **"The proposed changes in depreciation rates, if approved, would impact directly three elements of SourceGas Distribution's cost of service for ratemaking purposes at the time that SourceGas Distribution files its next request for a general increase in rates for its Jurisdictional Residential and Commercial customer classes. Those three elements are SourceGas Distribution's depreciation expense, accumulated reserve for depreciation and amortization, and accumulated deferred income taxes ("ADIT"). This is because the change in depreciation rates would generate a lower annual depreciation expense that would need to be collected from Jurisdictional customers. The Company's proposal to lower the depreciation rates effective May 1, 2014 would result in less accumulated depreciation in its next general rate case filing. This lower amount of accumulated depreciation, however, would be partially offset by a higher amount of ADIT, because there would be a greater difference between the book and tax depreciation on Nebraska assets as a result of the change in depreciation rates, and would be more than offset by lower depreciation expenses."[25]**

Does the statement that the ADIT would be "higher" eliminate the problems you have discussed that result from the fact that the accumulated depreciation reserve would be lower than the accumulated depreciation actually charged ratepayers?

A. No. The amount by which the ADIT would be "higher" would be much less than the amount by which the accumulated depreciation reserve would be lower than it should be. In the next general rate case the ratepayers would be paying a rate-of-return on ratepayer-provided funds, even allowing for a higher ADIT. The "higher" ADIT would be more than offset by the lower accumulated depreciation reserve.

[25] Starting on page 9, line 18 of the Prefiled Direct Testimony of Jerrad S. Hammer.

In addition, the ADIT is not used in the calculation of the depreciation rates in a depreciation study, so the Company would double recover part of the investment, just as I previously discussed.

Q. Mr. Hammer states "This lower amount of accumulated depreciation, however, would be partially offset by a higher amount of ADIT". In response to discovery did Mr. Hammer quantify what is meant by "partially offset" in this statement?

A. No. In Information Request No. PA-23(b) we asked SourceGas to "provide the dollar amount or approximate dollar amount by which the 'amount of ADIT' would be 'higher' in 'its next general rate case filing' than it would have been had the current depreciation rates continued in effect."

The Company provided no amount, the Company response included: "Due to the manual nature of this type of calculation and the fact that it is unknown at this time when the next rate case filing will be made, the <u>Company cannot quantify an amount by which</u> ADIT would be higher than it would be if the current depreciation rates were to continue in effect."[26] (Emphasis added)

The Company did not provide even an "approximate" dollar amount by which the amount of ADIT would be higher.

[26] Company Response to Information Request No. PA-23(b).

Q. Did SourceGas provide an ADIT worksheet that can be used to approximate how much of the reduction in the accumulated depreciation reserve would be "partially" offset by an increase in ADIT?

A. Yes. In response to Information Request No. PA-54 in Docket No. NG-0078, SourceGas provided an Excel workpaper entitled "WP-ADIT Calculations". This included ADIT and accumulated depreciation reserve calculations starting May of 2104 through December of 2015.

When I changed the input book depreciation rates between the current depreciation rates and the depreciation rates SourceGas has proposed, the ADIT amount went up by only 39% of the amount by which the accumulated depreciation reserve went down. The "higher" ADIT amount does not even offset half of the lower accumulated depreciation reserve that would be booked under the Company proposal.

Q. Are you testifying on the details of how ADIT is properly calculated?

A. No. I am not testifying on how ADIT is properly caclulated. The SourceGas ADIT experts are responsible for the ADIT calculations in that Company ADIT workpaper. I just used the ADIT Excel workpaper that the SourceGas ADIT experts had prepared and provided. Using SourceGas' own ADIT workpaper, changing the book depreciation rates results in the ADIT amount going up by only 39% of the amount by which the accumulated depreciation reserve goes down.

The "higher" ADIT amount does not even offset half of the lower accumulated depreciation reserve that would be booked under the Company proposal.

Under the Company proposal, ratepayers would be charged a rate-of-return on ratepayer-provided funds, as previously discussed. Nothing discussed in this case eliminates or offsets the majority of this problem, except continuing to use on the SourceGas books the same depreciation rates SourceGas is collecting from ratepayers.

IX. "Jurisdictional Revenue Deficiency" is Not One of the Inputs Used in the Calculation of Depreciation Rates

Q. In Docket No. NG-0079, which is this proceeding in which SourceGas proposes a change in the depreciation rates, Mr. Hammer filed testimony which states:

> **"My Direct Testimony presents a Jurisdictional revenue deficiency analysis…"[27]**

Is "jurisdictional revenue deficiency" one of the inputs used in the calculation of depreciation rates?

A. No, as SourceGas admitted in response to discovery. Information Request No. PA-36 (a) asked:

> "(a) Is it a correct statement that the "jurisdictional revenue deficiency" is not one of the inputs used in the calculation of depreciation rates?"

SourceGas responded:

> a. Correct

Information Request No. PA-36 (c) asked:

> "(c) In the Annual Depreciation Expense formula on the middle of page 18 of Exhibit DAW-4, please identify which of the elements (i.e. book reserve, or net salvage %, etc.) in that formula are (or are calculated using) the jurisdictional revenue deficiency or revenue requirement of the utility. If none, then state "none"."

SourceGas responded:

> "c. None"

[27] Page 3, line 21 of the Hammer Direct Testimony.

X. Future Net Salvage Percents

Q. Please explain your recommendation regarding the Company's proposed future net salvage percents.

A. My recommended future net salvage percents are consistent with the actual SourceGas salvage data. However, Mr. Watson's recommended future net salvage percents are not consistent with the actual SourceGas salvage data for three accounts, including the two largest accounts.

My recommended future net salvage percents are different than Mr. Watson proposal for three accounts; Account 376, Mains, Account 380, Services, and Account 382, Meter Installations. The table below compares the proposed future net salvage rates with the actual SourceGas experienced net salvage percents.

Table 3: COMPARISON OF FUTURE NET SALVAGE PERCENTS

Account	Description	Actual Historic Net Salvage Percent 2008-2013[28]	Watson Proposed Future Net Salvage Percent[29]	WDA Proposed Future Net Salvage Percent
376	**Mains**	**+0.4%**	**-10%**	**0%**
380	**Services**	**-10.7%**	**-40%**	**-11%**
381	House Meters	+0.8%	0%	0%
381.1	AMR Equipment	0%	0%	0%
382	**Meter Installation**	**0%**	**-10%**	**0%**
383	House Regulators	NA	0%	0%

As can be seen on the above table, my recommendation for Account 376, Mains, Account 380, Services, and Account 382, Meter Installations are supported by the actual experience of SourceGas in Nebraska. Mr. Watson has not provided any supportable

[28] Appendix D of Exhibit DAW-4
[29] Appendix C and A of Exhibit DAW-4

explanation which shows the future net salvages will be significantly different than the recent actual experienced net salvage.

Q. Should the actual historical net salvage experience be the only data considered in setting the future net salvage percent?

A. No. The Company's actual historical experience is a valid starting point in the analysis, since that historical experience includes the impact of management decisions of that specific company, any unique condition in the service area, and any regulatory mandates that apply to that specific company. A depreciation analyst also considers any future plans that differ from the past practices that will impact the future net salvage percents.

There was no valid support for Mr. Watson's claims that the future company practices will differ enough from the current Company practices to support the more negative net salvage percents Mr. Watson proposes.

Q. Page 27 of the Depreciation Study (Exhibit DAW-4) states:

> **"In this case, the analysis not only looks at the historical experience but also takes into account the Company <u>undercharging removal cost</u> in the last few years in Accounts 376, 380 and 382." (emphasis added)**

Was Mr. Watson able to support his claimed "undercharging" of removal costs?

A. No. In response to discovery regarding this claimed "undercharging" the Company's Director-Rates and Regulatory witness Mr. Hammer stated:

> "To reiterate, the Company has <u>not</u> been undercharging removal cost. …"[30] (Emphasis added)

A copy of this response to attached as Exhibit WDA-4.

[30] Company Response to Information Request No. PA-24(b).

Q. Page 27 of the Depreciation Study (Exhibit DAW-4) Mr. Watson goes on to state regarding the claimed "undercharging" that:

> **"Addressing the undercharges through the Company's implementation of PowerPlan in 2015 will lead to changes in net salvage charges and a more negative future expectation for net salvage than was experienced in the past."**

Was the Company able to provide support showing that the "implementation of PowerPlan in 2015 will lead to changes in net salvage charges and a more negative future expectation for net salvage than was experienced in the past"?

A. No. In response to discovery regarding this claim the Company stated:

> "<u>There are no documents to support the claim</u> that converting to Power Plan software in 2015 "will lead to … a more negative future expectation for net salvage than was experienced in the past." It is the opinion of the Company that with the implementation of new technology, the Company should realize higher removal cost primarily due to enhanced tracking capabilities."[31] (Emphasis added)

Q. What do you recommend regarding the Company's future net salvage proposal?

A. Based on my analysis, I believe that SourceGas' past experience is a valid indicator of what is reasonably expected in the future.

A Company witness specifically rejected Mr. Watson's claim that SourceGas has been "undercharging removal cost". Mr. Watson's salvage factors that are based on this incorrect "undercharging" claim should be rejected. Mr. Watson could not provide any convincing support for his claims that the future will be enough different from the past to cause the future net salvage percents to be so much more negative as compared to the current experience.

[31] Company Response to Information Request No. PA-39(b).

As shown in Table 3 above, my recommendations are supported by the recent actual experience of SourceGas.

XI. Conclusion

Q. What is your recommendation?

A. For the reasons stated in this testimony, I recommend that the new depreciation rates that result from the Commission order in this proceeding first be booked at the same time that next SourceGas general rate case rates (prices) go into effect.[32]

I also recommend the depreciation rates shown in column G on page 1 of Exhibit WDA-1 be adopted. The depreciation rates on Exhibit WDA-1 incorporate the future net salvage percents that are supported by the actual SourceGas data, as discussed in this testimony.

Q. Does this conclude your Direct Testimony?

A. Yes.

[32] Unless the Commission has further revised the depreciation rates by that time. A minor difference in timing, such as making the revised depreciation rates effective on the 1st of a month for ease of calculations, would not be significant or objectionable.